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In the Supreme Court of the United States

OCTOBER TERM, 1954

LEWYT CORPORATION (NOW KNOWN AS LEWYT MANUFACTURING CORPORATION), PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statute and regulations involved	2
Statement	3
Summary of argument	6
Argument:	
Introduction	13
I. The Code does not permit an accrual basis taxpayer, computing a net operating loss for 1946, to deduct excess profits taxes paid in 1946 which had accrued in 1945	16
II. Under Section 122(d)(6), as incorporated by reference in Section 122(b)(1), "The amount of tax imposed by subchapter E of Chapter 2 [Excess Profits Tax] paid or accrued within the taxable year" is the amount of excess profits tax ultimately found to be due for that year and not the amount which taxpayer originally reported on its return	25
A. The setting of the problem	25
B. For purposes of the "(d)(6)" adjustment, the tax "imposed" is the tax ultimately found to be due	32
Conclusion	39
Appendix A	1a
Appendix B	12a

CITATIONS

Cases:

Aramo-Stiftung v. *Commissioner*, 172 F. 2d 896	19
Birmingham v. *Loetscher Co.*, 188 F. 2d 78	19
Commissioner v. *Clarion Oil Co.*, 148 F. 2d 671, certiorari denied, 325 U.S. 881	8, 9, 19, 20
Helvering v. *Morgan's, Inc.*, 293 U.S. 121	23
Manning v. *Seeley Tube & Box Co.*, 338 U.S. 561	13, 36

Cases—Continued

	Page
Reo Motors v. *Commissioner*, 338 U.S. 442	18
Standard Roofing & Material Co. v. *United States*, 199 F. 2d 607	35
Stevens, Harry M., Inc. v. *Johnson*, 115 F. Supp. 310	19
Stow Mfg. Co. v. *Commissioner*, 190 F. 2d 723, certiorari denied, 342 U.S. 904	35

Statutes:

Internal Revenue Code of 1939:	
Sec. 23 (26 U.S.C. 1952 ed., Sec. 23)	2, 1a
Sec. 26 (26 U.S.C. 1952 ed., Sec. 26)	25
Sec. 41 (26 U.S.C. 1952 ed., Sec. 41)	2, 1a
Sec. 43 (26 U.S.C. 1952 ed., Sec. 43)	2, 23, 1a
Sec. 48 (26 U.S.C. 1952 ed., Sec. 48)	2, 7, 9, 16, 23, 1a
Sec. 102 (26 U.S.C. 1952 ed., Sec. 102)	24, 37
Sec. 122 (26 U.S.C. 1952 ed., Sec. 122)	2, 5, 7, 8, 10, 11, 12, 13, 16, 19, 26, 27, 29, 31, 32, 34, 37, 38, 39
Secs. 331-340 (26 U.S.C. 1952 ed., Secs. 331-340)	21
Sec. 337 (26 U.S.C. 1952 ed., Sec. 337)	21
Sec. 507 (26 U.S.C. 1952 ed., Sec. 507)	21, 22
Sec. 710 (26 U.S.C. 1952 ed., Sec. 710)	2, 30
Sec. 711 (26 U.S.C. 1952 ed., Sec. 711)	2
Revenue Act of 1926, c. 27, 44 Stat. 9:	
Sec. 200	23, 24
Sec. 206	24
Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 105	24, 25

Miscellaneous:

Rev. Rul. 6, 1953-1 Cum. Bull. 120	37
Treasury Regulations 111:	
Sec. 29.41-1	2, 1a
Sec. 29.41-2	2, 1a
Sec. 29.43-1	2, 1a
Sec. 29.122-1	2, 1a
Sec. 29.122-2	2, 1a
Sec. 29.122-4	3, 26, 1a
Sec. 29.122-5	3, 26, 10a

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OPINIONS BELOW

The opinion of the Court of Appeals (R. 57-73) is reported in 215 F. 2d 518. The opinion of the Tax Court (R. 23-36), rendered *en banc*, is reported in 18 T. C. 1245.

JURISDICTION

The judgment of the Court of Appeals was entered on July 14, 1954. (R. 74.) Taxpayer's petition for rehearing was denied on August 24, 1954.

(R. 75.) The petition for a writ of certiorari was filed on October 20, 1954, and granted on December 6, 1954, limited to Questions 1 and 2 presented by the application for the writ. (R. 75-76.) The jurisdiction of this Court rests upon 28 U.S.C., Section 1254.

QUESTIONS PRESENTED

1. Whether, under Section 122(d)(6) of the Internal Revenue Code, a taxpayer on the accrual basis can, in computing its net operating loss for one year, deduct the amount of excess profits taxes which were paid in that year but had accrued in an earlier year.

2. Whether under Section 122(d)(6), as incorporated by reference in Section 122(b)(1), "the amount of tax imposed by Subchapter E of Chapter 2 [the excess profits tax] paid or accrued within the taxable year" is the amount taxpayer originally reported on its return for excess profits tax or the sum ultimately found to be due for that year.

STATUTE AND REGULATIONS INVOLVED

The pertinent statutory provisions (Sections 23(c)(1) and (s), 41, 43, 48(c), 122, 710(a)(1) and (b), 711(a)(1)(J) and (2)(L) of the Internal Revenue Code of 1939[1] and Treasury Regulations (Treasury Regulations 111, Sections 29.41-1, 29.41-2, 29.43-1, 29.122-1, and 29.122-2) are the same as those set forth in the brief for the United States in the companion case of *United States* v. *Olympic*

[1] All references to the "Internal Revenue Code" or "Code" are to the "Internal Revenue Code of 1939" unless otherwise expressly noted.

Radio and Television, Inc., No. 10, Appendix A, pp. 36-53, with the exception of Treasury Regulations 111, Sections 29.122-4 and 29.122-5, set forth in Appendix A, *infra*, pp. 1a-11a.

STATEMENT

The facts relevant to the two questions presented for review are not in dispute. They may be summarized as follows:

Taxpayer is a New York corporation engaged in the manufacture of vacuum cleaners and electronic devices. It maintained its books and records and filed its tax returns on the accrual method of accounting, using a fiscal year ending September 30th.[2] (R. 24, 37-38, 57.)

The years 1944 and 1945 were profit years for taxpayer, and were followed by loss years in 1946 and 1947. In this Court, the controversy is limited to (a) the proper computation of the net operating loss for 1946, and (b) the proper application of the net operating losses for 1946 and 1947 as carrybacks to the income of the profit years 1944 and 1945.

Taxpayer's 1943 return stated an excess profits tax liability of $759,916.50. It paid that amount in 1944. (R. 24, 70.) Its ultimate liability, however, was fixed at $140,147.87. (R. 26, 61.)

The excess profits tax for 1944 originally reported by taxpayer on its return was $325,561.59 (R. 40A, 70-71). In 1945, it paid $510,939.23 on

[2] Taxpayer's fiscal years will be referred to by the calendar year in which each ended.

account of its 1944 excess profits tax (R. 24). The excess profits tax for 1944 ultimately found by the Commissioner to be due was $280,540.33 (R. 9, 24, 71). Net income for the same year was found to be $420,540.43 (R. 4, 24).

The excess profits tax for 1945 originally reported by taxpayer on its return was $861,118.04 (R. 25, 56A). This sum was paid by taxpayer in 1946 (R. 25, 66). The excess profits tax for 1945, as found by the Commissioner, was $192,810.61 (R. 2, 17). Net income for the same year was found to be $282,869.25[3] (R. 11).

For the years 1946 and 1947, taxpayer incurred net operating losses of $164,326.38 and $786,383.25, respectively. (R. 24.) Net operating losses in these amounts were allowed by the Commissioner as carry-back deductions to the years 1944 and 1945. (R. 4, 11, 24-25.)

Taxpayer's basic position (Taxpayer's Br., Point I) is that, under Section 122(d)(6), it is entitled to augment its 1946 net operating loss ($164,326.38) by the amount of excess profits taxes which it paid in 1946 ($861,118.04) on account of its 1945 excess profits tax liability. Under this view, the 1946 net operating loss available for carry-back purposes would be increased to $1,025,444 (*id.*, pp.

[3] Before the Tax Court, the Commissioner alleged that he had improperly allowed a $55,949.04 interest deduction for 1947. Disallowance of this deduction by the Tax Court (a matter not here in dispute) increased from $192,810.61 to $231,079.75 the excess profits tax for 1945. Correspondingly, it increased from $428,288.05 to $466,557.19 the deficiency for that year claimed by the Commissioner. (R. 23-24, 36-37.)

3-4; R. 60-66). It is the Commissioner's position that since taxpayer is on the accrual basis the excess profits tax liability which accrued in 1945 is not available for purposes of 1946 tax computations.

Taxpayer's second contention relates to the proper application of a 1946 net operating loss carry-back to the two preceding years. Under the statutory formula (see Section 122(b)(1), incorporating Section 122(d)(6) by reference), this requires a preliminary adjustment to taxpayer's 1944 net income. See Court of Appeals' opinion at R. 70-72 and discussion, *infra*, pages 25-31. Making this adjustment to 1944 net income involves, in part, the same type of question presented by taxpayer's first contention, *i.e.*, whether there is to be offset, as against 1944 net income, excess profits taxes paid in 1944 on account of the liability incurred for the previous year (taxpayer's position) *or* the excess profits tax liability accrued in 1944 (the Commissioner's position).[4] It also involves, however, a distinct question: Whether the excess profits tax to be offset against 1944 net income is the amount of excess profits tax *reported* for the year in question (as taxpayer contends) or the amount *ultimately found to be due* (as the Commissioner contends).[5]

[4] As to this aspect, the Court's holding on Question 1 will be dispositive.

[5] The practical significance of the dispute as to the proper deduction from 1944 net income is its effect, under the statutory formula, upon the amount of carry-back, if any, available

The Tax Court, sitting *en banc*, unanimously sustained the Commissioner's position on Questions 1 and 2 as here presented (R. 29-36), and assessed deficiencies accordingly (R. 36-37). The Court of Appeals (Clark, Hincks, and Harlan, JJ.) unanimously affirmed (R. 57-73) and denied taxpayer's petition for rehearing (R. 75).

SUMMARY OF ARGUMENT

If taxpayer prevails on both of its contentions in this case, it will be enabled to exploit actual operating losses of $950,709.63 (suffered in the loss years 1946 and 1947) so as to offset entirely total net income for 1944 and 1945 aggregating $1,654,119.31. Moreover, under its theories, it will still have available as a carry-over against potential income accruing in 1948 and 1949 an additional amount of more than $1,000,000.

Taxpayer's theory as to Question 2, standing alone, leads to the conclusion, no less extraordinary, that a 1946 net operating loss may be applied as an offset to net income earned in the second preceding year (1944) and still be available, undiminished in amount, for application against the income of the first preceding year (1945).

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not offset against 1945 net income. Note that, under Section 122(b)(1)(C), a net operating loss carry-back there, the 1946 loss must first be applied to the second preceding year (*i.e.*, 1944). Taxpayer would view the excess profits tax "imposed" as the amount it reported (rather than the lesser amount ultimately found to be due), because that would have the effect of minimizing 1944 net income and, by the same token, would maximize carry-back available for 1945.

The statute does not invite or compel these bizarre results. Fairly read, it precludes them.

I

The Code permits a taxpayer, in computing a net operating loss as defined in Section 122(a), to take into account, pursuant to Section 122(d)(6), excess profits taxes "paid or accrued" in the taxable year. Although this taxpayer is on the accrual basis, it would augment its operating loss for 1946 by the excess profits taxes accrued in 1945 and paid in 1946. This contention is the same as the one made by taxpayer in *United States* v. *Olympic Radio and Television, Inc.*, No. 10.

As fully set forth in our brief in No. 10, we believe that the issue is controlled by the explicit Code definition which declares that the "terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed . . ." (Section 48(e)). We have also pointed out in the Government's *Olympic* brief that Section 122(d)(6) was regarded by Congress as a "technical" amendment made necessary by contemporaneous revision of the excess profits tax law; that the legislative history of this particular subsection is obscure and inconclusive; and that, in sum, this history does no more than confirm the wisdom of confining the subsection within the limits imposed by its statutorily defined terminology. We do not elaborate these arguments here.

While taxpayer claims that the holding of the Court of Appeals is inequitable, it fails to show that its actual losses in 1946 and 1947 were given anything less than their full effect in the Commissioner's computation of carry-back available for application to 1944 and 1945. The basis of complaint is that only occasionally will the "(d)(6)" adjustment provide an additional benefit to an accrual basis taxpayer. Many tax provisions are apt to have a differing incidence depending upon the method of accounting chosen by the taxpayer. Moreover, while taxpayer asserts that Section 122 (d)(6), as construed below, favors cash basis taxpayers (which are few in number among corporations), it ignores the fact that its contention, if accepted, would cause widespread discrimination in large amounts in favor of corporate taxpayers having fluctuating income as opposed to those having relatively stable earnings. The net operating loss deduction provided by Congress was designed to relieve the taxpayer with fluctuating profit and loss years from unjust burdens. There is no basis for supposing that the corporation with fluctuating profit and loss years, but enjoying over-all profits, was to be equipped with a device for avoiding the imposition of taxes on its over-all profits and thereby placed in a special, privileged class.

The line of cases exemplified by *Commissioner* v. *Clarion Oil Co.*, 148 F. 2d 671 (C.A.D.C.), certiorari denied, 325 U.S. 881, was properly distinguished below. Those cases involved the penalty

tax on undistributed income of personal holding companies and rest on the rationale that a company is not to be penalized "for not distributing as dividends money which it either does not have, because it pays it out in back taxes during the year, or which prudence would require it to keep, because it will be needed to pay taxes accrued during the year though not payable until the following year . . ." (dissenting opinion of Judge Madden in the *Olympic* case, No. 10, R. 14). Indeed, the *Clarion Oil* decision itself emphasized (148 F. 2d at 676) that, in computing the penalty tax on undistributed income, "[t]here is absent the administrative need for uniformity which exists for the computation of net income." The determination of a net operating loss deduction is, of course, an integral part of the computation of net income. If one factor in calculation of loss is computed on the cash basis and other calculations of profit and loss are computed on the accrual basis, the necessary effect is to distort net income. Even without an explicit statutory definition, one would hardly ascribe to Congress the purpose of authorizing a single taxpayer to adopt internally inconsistent methods of computing profit and loss factors. Section 48(e) in terms forbids that practice.

Taxpayer also seeks support from provisions of the Code relating to the surtax (in the nature of a penalty) upon corporations improperly accumulating surplus. Examination of these provisions shows that they are irrelevant to the issue at hand.

II

A. The answer to Question 1 bears on the quantum of taxpayer's net operating loss for 1946. A net operating loss, once determined, may be utilized as a two-year carry-back or carry-over. Section 122(b). The remaining considerations in this case relate to application of the 1946 loss carry-back.

Under Section 122 (b) (1), a net operating loss for a given year (here, 1946) shall first be carried back and deducted from the net income of the second preceding year (1944). The section then provides in substance that the amount of carry-back available for application to the first preceding year (1945) shall be the excess of the 1946 net operating loss over a figure for 1944 net income adjusted in accordance with Section 122(d)(6). It is taxpayer's position that, in applying the carry-back to 1945 and in determining for that purpose the excess of the 1946 net operating loss over 1944 net income, it may deduct from 1944 net income either—

(a) the sum representing excess profits taxes *reported* for 1943 and paid in 1944, *or*
(b) the amount representing excess profits taxes *reported* for 1944.

The suggestion embraced in (a) that 1944 net income shall be adjusted on the basis of excess profits taxes which accrued in 1943 is the same contention made by taxpayer under Point I (though made here in relation to 1944 income). Since the mean-

ing of "paid or accrued," as used in Section 122 (d)(6), must, concededly, be the same whether a "(d)(6)" adjustment is being made to 1946 net loss (pursuant to Section 122(a)) or to 1944 net income (pursuant to Section 122(b)(1)), this presents no new legal issue. The holding under Point I will be dispositive.

However, a further, distinct issue is involved in taxpayer's contentions as set forth in propositions (a) and (b) above. Taxpayer is suggesting that the amount of excess profits tax to be deducted from 1944 net income is the amount *reported* rather than the amount *ultimately found to be due.* The practical consequence of this suggestion would be to make available for application to 1945 the entire amount of the 1946 net operating loss, notwithstanding its prior application in reduction of taxpayer's 1944 tax liabilities.

B. In 1944, taxpayer reported excess profits taxes more than double the amount ultimately found to be due. To the extent that the liability reported exceeded the liability as finally determined, the excess was refunded or credited. Nonetheless, taxpayer would treat the entire *reported* tax (including the major share which it has already gotten back once) as diminishing its 1944 net income and increasing, *pro tanto*, the figure to be used in computing the amount of carry-back remaining to it for application against 1945 net income. This position is untenable.

The Congressional purpose in authorizing a carry-back is plain. The law says in effect that,

when a loss year follows years of profit, there shall be a readjustment of tax liability for the earlier period in the light of the later event. It seems inconceivable that Congress proposed that this adjustment should be made without regard to the known and established facts relating to the liability for the earlier period. A law designed to provide relief retrospectively is scarcely to be read as conferring a double benefit.

The words of Section 122(d)(6) also stand in taxpayer's path. That provision allows as a deduction "the amount of [excess profits] tax imposed." There were not two excess profits taxes imposed for 1944, but only one, and that one was the amount as finally determined.

Taxpayer's theory, moreover, is internally inconsistent. It would deduct from 1944 net income a sum representing its uncorrected excess profits tax for 1944. But it does not suggest that this amount of reported tax be deducted from the uncorrected income figure on the basis of which it was computed. In the words of the Court of Appeals, taxpayer "is seeking . . . to have the benefit of both the *smaller* 1944 income as finally determined . . . and the *larger* excess profits tax . . . based upon the income as originally reported. . . . It cannot have it both ways at the same time . . ." (R. 71)

The effect of the decision below is that the net operating loss for 1946 (found, as a result of the holding under Question 1, to be $164,326.38) is applied in full against taxpayer's 1944 net income for purposes of determining taxpayer's 1944 tax liabilities.

The holding (Question 2) does not permit this sum to be applied a second time for purposes of reducing taxpayer's liabilities for 1945. The scheme of the carry-back and carry-over provisions, which contemplate a *de novo* determination (cf. *Manning* v. *Seeley Tube & Box Co.*, 338 U.S. 561, 567), and the language of Section 122(d)(6) alike support this result. Common sense is offended by the contrary suggestion that the internal revenue laws should be interpreted to permit full application of the carry-back in 1944 and its renewed application, in 1945, undiminished in amount.

ARGUMENT

Introduction

Before turning to the legal issues, we shall briefly indicate, by reference to the pertinent facts and figures, the practical consequences which result if one accepts taxpayer's position on the two issues stated above.

Putting aside carry-backs, taxpayer's net income for 1944 was $584,866.81, and its net income for 1945, $1,069,252.50. Total net income for the two years (excluding carry-backs) is thus $1,654,119.31.[6] In 1946, taxpayer had a net loss from its operations of $164,326.38. In 1947, its net loss from operations was $786,383.25. The total loss for these two years, $950,709.63, was recognized

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[6] Net income for 1944, $420,540.43, plus 1946 net operating loss carry-back $164,326.38, equals $584,866.81. (R. 4.) Net income for 1945, $282,869.25, plus 1947 net operating loss carry-back $786,383.25, equals $1,069,252.50. (R. 11.)

by the Commissioner as available for carry-back purposes.

Subtracting the $950,709.63 of net losses for 1946 and 1947 from the $1,654,119.31 of net income for 1944 and 1945, the Commissioner has found a difference of $703,409.68, representing an aggregate balance of income for 1944 and 1945. To this should be added an item of $55,949 originally improperly allowed by the Commissioner as a deduction (see fn. 3, p. 4, *supra*). With certain minor adjustments not here material, this results in approximately $750,000 taxable income. This income the Commissioner claimed and the courts below found to be subject to a total of $567,650.91 income and excess profits taxes.[7]

Taxpayer, while not disputing that the actual losses from operations in 1946 and 1947 aggregated only the sum of $950,709 63 (R. 38), nonetheless contends that it is entitled to statutory net operating loss carry-backs from those years sufficient to offset entirely the total $1,654,119.31 of net income for 1944 and 1945. It asserts, in short, that it is subject to no federal income or excess profits taxes whatsoever for those years. Additionally, its position, if sustained, would mean that it would have available a net operating loss carry-over from 1946 and 1947 to 1948 and 1949 of more than $1,000,000. See pages 26-30; Appendix B, Example 4, p. 28a, *infra*.

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[7] The total tax liability of $529,381.77 set forth in the deficiency notice (R. 2) was corrected to the figure stated in the text as a result of the Tax Court's action in correcting the Commissioner's understatement of the 1945 deficiency. See fn. 3, p. 4, *supra*.

In contrast, a corporation receiving for the same four-year period the same aggregate income (approximately $750,000), but earning a *pro rata* share each of the years in question, would be liable for excess profits and income taxes amounting to approximately $427,000.[8] It, of course, would have no carry-over available for subsequent years.

The anomaly of supposing with taxpayer that actual operating losses amounting to $950,709.63 may be used to offset more than $2,600,000 of actual or potential income (total income for 1944 and 1945 plus amount of carry-over against potential income accruing in 1948 and 1949) immediately suggests that petitioner is claiming for the tax laws a result which Congress could scarcely have contemplated —especially so, in light of the revenue-raising purposes of the wartime excess profits legislation.

Yet, incongruously, in advancing its main contention (that, in computing a net operating loss, an accrual basis taxpayer may take into account excess profits taxes paid in the loss year which accrued in the prior year), taxpayer urges that the intention to allow the extraordinary deductions which it seeks should be ascribed to Congress in order to prevent alleged inequities, and that this Court should therefore depart from an explicit statutory definition which, in terms, requires a result adverse to taxpayer.

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[8] See computations in Appendix B, Example 1, *infra*, pp. 12a-17a.

I

The Code Does Not Permit An Accrual Basis Taxpayer, Computing A Net Operating Loss for 1946, to Deduct Excess Profits Taxes Paid in 1946 Which Had Accrued in 1945.

In computing a net operating loss, as defined in Section 122(a) of the Code, a taxpayer may take into account, pursuant to Section 122(d)(6), the amount of excess profits taxes "paid or accrued" in the taxable year. Taxpayer contends that, in computing its net operating loss for 1946, it may include the excess profits taxes which it paid in 1946 on account of its 1945 excess profits tax liability, notwithstanding the fact that it is an accrual basis taxpayer. This is precisely the same position as is taken by the taxpayer in the companion case of *United States* v. *Olympic Radio and Television, Inc.*, No. 10.

In our brief in No. 10, we have fully set forth our reasons for believing that this issue is controlled by the explicit statutory definition which declares that the "terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed . . ." (Section 48(c)). See brief in No. 10, pages 11-20. We have also pointed out in that brief (pp. 22-34) that the legislative history of Section 122(d)(6) is at best inconclusive and that, far from supporting the view that the section should be construed without regard to the statutory definition of "paid or accrued," it serves to emphasize the wisdom of confining that section within the

limits imposed by its statutorily defined terminology. Instead of repeating these arguments *in extenso* here, we respectfully refer the Court to the cited portions of our brief in No. 10. The remaining portion of this Point I will be devoted to the criticisms of the Government's position which are advanced in taxpayer's brief.

1. Taxpayer argues repeatedly in its brief that, by applying the statutory definition of "paid or accrued," the Court of Appeals has caused an inequitable result. It fails to show, however, that any actual or economic loss suffered by it in its operations has been denied effect in the Commissioner's computation of its net operating loss deductions.

Moreover, as observed above (pp. 13-15), the over-all result which taxpayer seeks in this case would exempt it from all taxes for a four-year period during which it enjoyed aggregate net profits of approximately $750,000 and would enable it to claim, in addition, very substantial carry-overs (over $1,000,000) as against potential income of subsequent years. This analysis of taxpayer's claims takes into account its contentions on the two issues raised by this case. We have accordingly set forth in Appendix B, *infra*, pages 17a-27a, two examples (Examples 2 and 3) which are directed solely to the issue immediately under discussion (the meaning of "paid or accrued" for purposes of computing net operating loss). These examples picture, on the one hand, the case of a taxpayer having stable income year in and year out, and, on the other hand, the case of a taxpayer having

fluctuating income but earning over the years the same aggregate profits. The examples further illustrate that taxpayer's legal position as to the meaning of "paid or accrued," if adopted, would cause gross discrimination in favor of taxpayers having fluctuating income as opposed to those with stable earnings. The net operating loss deduction provided by Congress was designed to relieve the taxpayer with fluctuating profit and loss years from unjust burdens. There is not the slightest basis for supposing that the corporation with fluctuating profit and loss years, but enjoying over-all profits, was to be equipped with a device for avoiding the imposition of taxes on its over-all profits and thereby placed in a special, privileged class. See Government's Brief in No. 10, page 27. Compare *Reo Motors* v. *Commissioner*, 338 U.S. 442, 449: "We find no warrant for the view that Congress intended that a statute designed to equalize tax burdens should be used to produce net losses where none had previously existed."

Taxpayer here has no real basis for claiming that it has been unfairly treated. Its argument actually comes down to this: that a few cash basis corporate taxpayers may be in a position to secure more favorable treatment. As pointed out in the Government's brief in No. 10, many provisions of the tax laws have a differing incidence depending on the method of accounting being used and it is presumed that the advantages and disadvantages achieve a rough balance over the years, especially since the taxpayer has an election as to which method it will

utilize. It is also evident that there are circumstances in which accrual basis taxpayers may obtain substantial benefits under Section 122(d)(6).[9] In any event, as taxpayer correctly asserts (Br., p. 32), there are "comparatively few cash basis corporate taxpayers." The argument that, under the Government's construction, some of these few may be in a position to obtain more favorable treatment than accrual basis taxpayers is a poor crutch upon which to lean in asserting that the Court should adopt a construction which would cause wholesale discrimination, in very large amounts, in favor of taxpayers having fluctuating income as opposed to those whose earnings are relatively stable. There is no indication that Congress contemplated the extravagant results to which taxpayer's position would lead (see Govt. Br. in No. 10, pp. 28-32), and there is accordingly every reason to adhere to the explicit and long-established statutory definition of "paid or accrued."

2. Taxpayer places considerable reliance upon the line of cases exemplified by *Commissioner* v. *Clarion Oil Co.*, 148 F. 2d 671 (C.A.D.C.), certiorari denied, 325 U.S. 881.[10] However, these cases,

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[9] One example (see Govt. Br. in No. 10, pp. 18-19) is when disputed excess profits taxes of earlier years accrue through settlement or discharge in the loss year. Indeed, the instant taxpayer, in the court below, claimed such an accrual, asserting an addition of more than $355,000 to its 1947 net operating loss. It failed because of a failure in proof. (R. 60-65.)

[10] See, also, *Aramo-Stiftung* v. *Commissioner*, 172 F. 2d 896 (C.A. 2d); *Birmingham* v. *Loetscher Co.*, 188 F. 2d 78 (C.A. 8th); *Harry M. Stevens, Inc.* v. *Johnson*, 115 F. Supp. 310 (S.D.N.Y.), pending on appeal, C.A. 2d.

which involve the penalty surtax on undistributed income of personal holding companies, were properly distinguished in both courts below (R. 33, 68-69) and in the Government's brief in No. 10 (pp. 16-17). The distinction is summarized in Judge Madden's dissenting opinion in the *Olympic* case (No. 10, R. 14), as follows:

> To penalize a corporation for not distributing as dividends money which it either does not have, because it pays it out in back taxes during the year, or which prudence would require it to keep, because it will be needed to pay taxes accrued during the year though not payable until the following year, would seem to amount to penalizing sound management. The instant situation presents no comparable pressure of equity against the text of the statutes.

It should also be noted that in the *Clarion Oil* decision itself the court pointed out (148 F. 2d at 676) that in computing the penalty tax on undistributed income, "[t]here is absent the administrative need for uniformity which exists for the computation of *net* income." The determination of a net operating loss deduction is, of course, an integral part of the computation of net income. To permit one factor in calculation of loss to be computed on the cash basis, while all other calculations of profit and loss entering into a determination of net income are computed on the accrual basis, necessarily distorts net income. The precise function of

Sections 43 and 48(c) is to avoid such a result.[11]

Taxpayer also asserts that the court below misapprehended the *Clarion Oil* line of cases. It states (Br. 21) that the court below—

> plainly in error . . . overlooked Section 507(a) of the Code . . . which states that
>
> "The terms used in this subchapter [subchapter A of Chapter 2, the statute involved in *Clarion Oil*] shall have the same meaning as when used in Chapter 1."

This is rested upon the following sentence in the Court of Appeals' opinion (R. 68): "*Stated otherwise*, Chapter 2 contains no provisions comparable to §48(c) and §43 of Chapter 1 defining the phrase 'paid or accrued.'" (Emphasis added.)

A reading of the two preceding sentences (not quoted by taxpayer) shows, however, that the court was not oblivious of Section 507(a), and that it correctly interpreted the *Clarion Oil* case as holding that the Chapter 1 definition of "paid or accrued" was not meaningful for purposes of determining

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[11] The scheme of the Code with respect to taxation of undistributed income of foreign personal holding companies (Sections 331-340) does not support taxpayer's argument as to the meaning of the *Clarion Oil* cases (Br., pp. 26-27). In computation of the undistributed income of these companies there is also absent the administrative need for uniformity which exists for the computation of net income. That the tax is imposed not upon the company but upon its "United States shareholders" in the guise of a constructive dividend seems quite irrelevant. Section 337. There is, of course, no correlation between accounting systems or income computation of a corporation and a stockholder.

when a personal holding company had undistributed income. These two sentences read as follows (R. 68):

> The ground of these decisions, as exemplified by *Clarion*, is that the provisions of § 48(c) in Chapter 1 of the Internal Revenue Code defining "paid or accrued" in terms of a taxpayer's method of reporting for the purpose of computing *net income* under that Chapter, have no application to the meaning of § 505 (a)(1) permitting deduction of excess profits taxes for the purpose of computing the *undistributed income* tax on personal holding companies under Chapter 2. "But, obviously, this definition [48(c)] was intended to apply to the method of computing *net income*, and has no reference or relevancy to the subject matter of what, for the purposes of the newly added provision in relation to personal holding companies is taxable as *undistributed* income." *Clarion*, at p. 675.[12]

Resting on the *Clarion Oil* line of cases, taxpayer further asserts (Br. 20) that "[i]t is the established rule that the term 'paid or accrued' may have different meanings in the Internal Revenue Code, and that, where appropriate to carry out the statutory purpose, the ordinary meaning of *either* 'paid or accrued' will be applied rather than

[12] It may be noted additionally that the Tax Court's opinion (R. 33) expressly noted Section 507(a) and that the court below considered it unnecessary to amend the questioned language in its opinion when this point was pressed upon it by taxpayer's petition for rehearing.

the statutory definition in Section 48(c)." But, as the preceding discussion shows, those cases actually confirm the Government's contention that in computation of net income and in taking deductions incident to calculation of net income (of which the net operating loss is one) the term "paid or accrued" possesses only one meaning—that prescribed in Sections 43 and 48(c). Moreover, the construction of "paid or accrued" required by those sections, *i.e.*, according to the method of accounting upon the basis of which net income is computed, surely constitutes the term's "ordinary" meaning in the context of determination of net income or of deductions taken incident to net income calculation. A contrary construction—one that would permit a taxpayer to elect one basis for certain deductions and the other basis for others—must distort net income. Even without an explicit statutory definition, one would hardly ascribe to Congress the purpose of authorizing a single taxpayer to adopt internally inconsistent methods of computing profit and loss factors.

Helvering v. *Morgan's, Inc.*, 293 U.S. 121, also cited by taxpayer (pp. 20-21), affords it no support. The Court noted (p. 128) that the phrase "taxable year" there involved possessed more than one meaning "by the Government's own construction"; on the contrary, "paid or accrued," for purposes of computing net income, has only one statutory meaning.[13]

[13] Moreover, in *Morgan's, Inc.*, this Court applied the cognate of Section 48(a) (Revenue Act of 1926, c. 27, 44 Stat. 9, Section 200(a)) to the net loss provision of the 1926 Act

3. Taxpayer asserts (Br., p. 32) that subsection (e)(2) of Section 105 of the 1942 Act furnishes a key to the Congressional purpose—a suggestion which is made for the first time in this Court. In our view, that subsection is irrelevant to the issue at hand.

Section 102 of the Internal Revenue Code imposes a surtax in the nature of a penalty on corporations improperly accumulating surplus. Section 102(d)(1) defines the income subject to the penalty tax, denoted as "section 102 net income." Congress did not intend that income which had been subjected to excess profits tax should additionally be subject to this penalty tax. Accordingly, Section 105(e)(2) of the 1942 Act amended Section 102(d)(1) of the Code so as to provide an additional item for subtraction in arriving at "section 102 net income," namely, net income "minus" . . . "Income Subject to Excess-Profits Tax.—The credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26(e)."

As explained in the Government's brief in No. 10, pages 26-34, the 1942 Act changed the base for the corporate tax by allowing a taxpayer, in

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(Section 206), just as the House Committee in recommending enactment of Section 122 assumed the applicability of the definition in Section 48(a) to Section 122 (see Government's brief in *Olympic*, p. 15, fn. 7). The dispute in *Morgan's, Inc.*, centered about the meaning of Section 200(a); its materiality in construing the net loss provision was not in question (p. 130). The apparent implication to the contrary in taxpayer's brief (p. 28, fn. 22) is incorrect.

computing the normal tax and surtax, to use as a credit the amount of adjusted excess profits net income, instead of (as theretofore) a deduction in the amount of the excess profits tax itself. See Government's brief in *Olympic*, Appendix B, Examples 1 and 2, pages 54-55. This credit was provided in Section 26(e) as added by Section 105(d) of the 1942 Act. Thus, subsection (e)(2) did no more than allow, in the case of the surtax on corporations improperly accumulating surplus, the same credit against net income that was generally allowed in computing the normal tax and surtax. It was thus aptly included in Section 105(e) among "Technical Amendments Made Necessary by Change in Base for Corporate Tax." It does not serve to advance the argument here one way or the other.

II

Under Section 122(d)(6), As Incorporated by Reference In Section 122(b)(1), "The Amount of Tax Imposed By Subchapter E of Chapter 2 [Excess Profits Tax] Paid or Accrued Within the Taxable Year" Is the Amount of Excess Profits Tax Ultimately Found to be Due for That Year and Not the Amount Which Taxpayer Originally Reported on Its Return.

A. *The Setting of the Problem*

As indicated under Point I, the answer to the first question in this case bears on the quantum of taxpayer's net operating loss for 1946. A net operating loss, once determined, may be utilized as

a two-year carry-back or carry-over. Section 122 (b). The remaining considerations in the case relate to the manner of applying the 1946 net operating loss carry-back to the profit years 1944 and 1945.[14] The governing statutory provision is Section 122(b)(1).[15] See, also, Treasury Regulations 111, Sections 29.122-4 and 29.122-5 (Appendix A, *infra*, pp. 1a-11a).

Section 122(b)(1) directs that the net operating loss for a given year (here, 1946) shall first be carried back and deducted from the income of the second preceding year (1944). Thus, on taxpayer's theory, one would apply a 1946 net operating loss totaling $1,025,444.42 against a 1944 net income

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[14] As will appear, these considerations are not divorced from factors involved in the discussion under Point I.

[15] Sec. 122. [As added by Sec. 211(b) of the Revenue Act of 1939, c. 247, 53 Stat. 862] NET OPERATING LOSS DEDUCTION.

* * * * *

(b) [As amended by Sec. 153(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(before carry-back) of $584,866.81.[16] This would entirely wipe out taxpayer's income and excess profits tax liabilities for 1944. On the Government's theory, the net operating loss for 1946 is $164,326.38. Application of that figure against $584,866.81 would diminish but not eliminate taxpayer's liabilities for 1944.

Difficulties arise, however, from taxpayer's contentions in relation to the effect of the 1946 net operating loss upon its liabilities for 1945. In determining the amount of carry-back available for the first preceding year (1945), Section 122(b)(1) provides in substance that it shall be the excess of the 1946 net operating loss over an adjusted figure for 1944 net income. As under Point I, it is the "(d)(6)" adjustment (but here in relation to 1944 income) which is the bone of contention. Taxpayer's position on application of the carry-back is

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[16] The following table illustrates its position graphically:

1944		
Net income before carry-back of 1946 net operating loss (R. 4, 70; Taxpayer's Br. p. 5)		$ 584,866.81
Loss carry-back for 1946 computed as follows:		
1946 net operating loss (R. 70) exclusive of Section 122(d)(6) adjustment	$164,326.38	
1945 excess profits tax paid in 1946 (R. 66; Taxpayer's Br. p. 4)	861,118.04	
Total 1946 net operating loss		1,025,444.42
Net income		($ 440,577.61
Income tax		0 *

* Excess profits tax is also zero. Section 710(a)(1)(B).

summarized in the Court of Appeals' opinion (R. 70-71) as follows:

> The taxpayer contends that in computing the amount of the 1946 net operating loss . . . which is to be carried back to 1945, there should first be offset against 1944 net income ($584,866.81) either (a) the sum of $759,916.50, being the amount of the 1943 excess profits taxes reflected in the taxpayer's return for that year and *paid* by it in 1944, or (b) the sum of $625,561.59, being the amount of the 1944 excess profits taxes as reflected in the taxpayer's return for 1944, and which it claims *accrued* in 1944. Since under (a) the 1943 excess profits taxes *paid* in 1944 ($759,916.50) exceeded by $175,049.69 the unadjusted net income for 1944 ($584,866.81) and under (b) the 1944 excess profits taxes *accrued* for that year ($625,561.59) exceeded by $40,694.78 such net income for 1944 ($584,866.81), the taxpayer claims that the entire 1946 net operating loss . . . constitutes a "carry-back" to 1945.

Taxpayer thus asserts, to begin with, that its net operating loss (claimed to be $1,025,444.42) wipes out 1944 tax liabilities. It then asserts, in substance, that its 1944 income, amounting to well over half a million dollars, *although wiped out by the 1946 net operating loss for purposes of computing taxpayer's 1944 taxes, failed to absorb a single penny of the 1946 net operating loss for purposes*

of determining what is available for carry-back to 1945. In the Court of Appeal's words (R. 70-71), "taxpayer claims that the entire 1946 net operating loss . . . constitutes a 'carry-back' to 1945." Stated graphically, taxpayer reaches this result as follows:

1945

A.	Computation of net operating loss carry-back from 1946 to 1945		
	1946 net operating loss		$1,025,444.42
	Less: 1944 income without regard to 1946 net operating loss (Sec. 122(b) (1) (B)	$584,866.81	
	Less: *1943 excess profits tax reported by taxpayer, paid in 1944* (Sec. 122(b) (1) (A)) (R. 70; Br. 5)	759, 76.50 [17]	
	Total 1946 net operating loss absorbed by 1944 net income		—0—
	Amount of 1946 net operating loss carried back to 1945		$1,025,444.42
B.	Computation of 1945 net operating loss deduction		
	Carry-back from 1946		$1,025,444.42
	Carry-back from 1947 (R. 60)		786,383.25
	1945 net operating loss deduction (Sec. 122 (c))		$1,811,827.67

[17] If one substitutes for this figure the sum of $625,561.59, representing the sum of excess profit tax *reported* for 1944 taxpayer's alternate suggestion the end result remains unchanged: the total net operating loss absorbed by 1944 net income is still zero.

C. Income and Excess Profits Tax Computation

1945 net income before carry-back (R. 10-11)[18]	$1,069,252.50
Less: Net operating loss carry-back	1,811,827.67
Net income	($742,575.17)[19]
Income Tax	—0—
Excess Profits Tax under Section 710(a) (1) (B)	—0—

Recapitulating, taxpayer's over-all position embraces these propositions:

(1) In computing net operating loss for 1946, it may include excess profits taxes accrued in 1945 and paid in 1946, notwithstanding the fact that it is an accrual basis taxpayer.

(2) In applying the carry-back to 1945 and in determining for that purpose the excess of the 1946 net operating loss over 1944 net income, it may deduct from 1944 net income either—

(a) the sum representing excess profits taxes *reported* for 1943 and paid in 1944, *or*

(b) the amount representing excess profits taxes *reported* for 1944.

Whether in making the "(d)(6)" adjustment to 1944 net income one should deduct excess profits taxes accrued in 1943 and paid in 1944 or excess profits taxes accrued in 1944 is the same question

[18] Net income for 1945 of $282,869.25, plus 1947 net operating loss carry-back, $786,383.25.

[19] Application of taxpayer's theory, in computing carry-overs for future years under Section 122(b)(2), would have the effect of adding to this minus figure of $742,575.17, the amount of 1944 excess profits tax reported by taxpayer, paid in 1945.

considered under Point I. The meaning of "paid or accrued," as used in Section 122(d)(6), must be the same—and, as to this, there is no argument between the parties—whether a "(d)(6)" adjustment is being made to 1946 net loss (pursuant to Section 122(a)) or to 1944 net income (pursuant to Section 122(b)(1)). However, a further, distinct issue is involved in taxpayer's contentions as set forth in propositions 2 (a) and (b) above. Taxpayer is suggesting that the amount of excess profits tax to be deducted from 1944 net income is the amount *reported* rather than the amount *ultimately found to be due*. This issue is in the case irrespective of the Court's holding under Point I as to the amount of 1946 net operating loss. [20]

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or $510,939.23, making available a carry-over for 1948 and 1949 in excess of $1,000,000. (See computation, Example 4, Appendix B, *infra*, p. 28a.)

[20] The decision of the courts below, which ruled in favor of the Government on Questions 1 and 2, has the following effect:

1945

Computation of net operating loss carry-back from 1946 to 1945		
1946 net operating loss		$164,326.38
Less: 1944 income without regard to 1946 net operating loss (Sec. 122(b)(1)(B)	$584,866.81	
Less: *1944 excess profits tax actually imposed* (Sec. 122(b)(1)(A)	280,540.33	
Balance of 1944 income		304,326.48
Amount of 1946 net operating loss carry-back to 1945		—0—

(Footnote 20 continued on page 32)

B. *For Purposes of the "(d)(6)" Adjustment, the Tax "Imposed" Is the Tax Ultimately Found to be Due.*

Taxpayer reported $625,561.59 as its excess profits tax for 1944 (R. 40A, 70-71). The amount ultimately found due was $280,540.33 (R. 9, 24, 71). The difference was refunded or credited to taxpayer (R. 9).[21]

Taxpayer suggests, however, that in determining the amount of carry-back from 1946 absorbed by 1944 net income (Section 122(b)(1)) one should deduct from 1944 net income the amount of excess

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(Footnote 20 continued from page 31)

If, however, taxpayer were to prevail on Question 2, one would substitute for the italicized item the sum of $625,561.59 (excess profits tax for 1944 as originally reported by taxpayer). This would result in a "balance of 1944 income" of zero and "a net operating loss carry-back to 1945" of $164,326.38. *Again, the result would be that taxpayer would receive the benefit of the entire 1946 net operating loss in 1945, notwithstanding the fact that it had already applied the full amount of that loss in reduction of its 1944 liabilities.*

Moreover, if taxpayer should prevail on Point I and the Government should prevail on Point II, adjustments would be required. See p. 39, fn. 28, *infra*.

[21] Similarly, taxpayer reported as its 1943 excess profits tax a sum ($759,916.50) (R. 24, 70) substantially in excess of that ultimately found to be due ($140,147.87) (R. 26, 61). The former amount was paid in 1944. The difference between the two amounts was refunded or credited. In our view, of course, the 1943 data is immaterial from the standpoint of adjustment of 1944 net income since taxpayer is on the accrual basis (see Point I). But for purposes of the point now under discussion—whether one deducts from 1944 net income the excess profits tax reported or that ultimately found due—the principle is the same whether taxpayer or the Government is correct on Point I.

profits tax reported for 1944.[22] In short, it urges that an amount which it has already gotten back once (the difference between $625,561.59 and $280,540.33) should be treated as diminishing its 1944 net income. On this basis, it would increase, *pro tanto*, the figure used in computing the amount of carry-back available to it for application against 1945 net income. The practical consequence, as revealed in the computations set forth above (see pp. 29-30 and p. 27, fn. 16), is that taxpayer would get the benefit of the 1946 carry-back in 1944 and still have the benefit of the *entire* carry-back in 1945. This position is untenable.

The basic purpose of Congress in authorizing a carry-back is plain. The law says in effect that, when a loss year follows years of profit, there shall be a readjustment of tax liability for the earlier period in the light of the later event. It seems inconceivable that Congress proposed that this adjustment should be made without regard to the known and established facts relating to the liability for the earlier period. Yet, taxpayer, in order to enhance its carry-back, would have the Commissioner, in making the retrospective adjustment, include in his determination of the tax liability "im-

[22] This statement assumes that the Government is correct on Point I. On the contrary assumption, taxpayer's position is that one should deduct from 1944 net income the amount of excess profits tax reported for 1943 and paid in 1944 (rather than the corrected excess profits tax liability for 1943). As indicated in the preceding footnote, the principle involved is the same. Consequently, we shall not repeat the alternatives at each stage of the ensuing argument.

posed" during the earlier period an amount already once refunded or credited to the taxpayer. A law designed to provide relief retrospectively is scarcely to be read as providing a double benefit, especially where the claim to double benefit is predicated upon the use of a figure which has no economic reality.

Under the statutory formula, the amount of carry-back available for the first preceding year (1945) is the excess of the carry-back over the net income for the second preceding year (1944) as adjusted pursuant to Section 122(d)(6). Subsection (d)(6) expressly allows as a deduction "the amount of [excess profits] tax imposed. . . ." There were not two excess profits taxes imposed for 1944, but only one, and that one was the amount as finally determined after the making of some thirteen corrections (R. 4-6).[23]

Taxpayer's theory suffers, moreover, from a glaring internal inconsistency. Taxpayer would deduct from 1944 net income the sum of $625,561.59 representing its uncorrected excess profits tax for 1944. But it does not propose that this sum be deducted from the uncorrected figure ($827,852.99) on the basis of which the reported tax was computed (R. 40A, Item 1). Its position is that it may deduct the *uncorrected* tax from the *corrected* net

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[23] Some of these corrections involve errors by taxpayer. Others reflect events (*e.g.*, renegotiation of war contracts) which occurred after the close of the taxable year. Taxpayer suggests only that the "reported" figure be used. Br., pp. 2, 38.

income ($584,866.81).[24] In the Court of Appeals' words (R. 71), "[w]hat the taxpayer is seeking to do is to have the benefit of both the *smaller* 1944 income as finally determined ($584,866.81) and the *larger* excess profits tax ($625,561.59), based upon the income as originally reported. . . . It cannot have it both ways at the same time by matching *determined* income against *returned* [*i.e.*, reported] excess profits taxes."

Taxpayer's approach may be illustrated concretely by taking one of the items originally included in taxpayer's 1944 return which became the subject of a later correction. Reported income for 1944 ($827,852.99) included accrued profits on certain outstanding war contracts. These accounted in substantial measure for the reported excess profits tax liability of $625,561.59. Subsequently, however, the contracts were renegotiated and the amount to which taxpayer became entitled thereunder was reduced by $397,970 (R. 4, 6). Taxpayer thereupon received a tax credit of $318,577.67 (R. 9) against the tax originally reported.[25]

In determining the amount of 1946 carry-back absorbed by 1944, taxpayer, as already observed, would reduce 1944 net income *as corrected* by 1944

[24] This figure represents the 1944 net income of $420,546.43 (upon which the excess profits tax as finally determined — $280,540.33 — was computed) plus the net operating loss of $164,326.38. (See R. 4.) For purposes of application of Section 122(b)(2), the income as finally determined is the 1944 income plus the 1946 net operating loss.

[25] The credit was allowed pursuant to Section 3806(b). *See Stow Mfg. Co. v. Commissioner*, 190 F. 2d 723 (C. A. 2d), certiorari denied, 342 U. S. 901; *Standard Roofing & Material Co. v. United States*, 199 F. 2d 507 (C. A. 10th).

excess profits tax *as reported*. This means, of course, that the principal sum of $397,970, originally reported as income, is out of the picture. Nonetheless, the amount of $318,577.67, representing the amount of reported tax on this principal sum, is to be deducted, according to taxpayer, from 1944 income as corrected. Credited once to taxpayer, it arises, phoenix-like, from the ashes. It stands, under taxpayer's view, as a liability "imposed" and serves to increase, *pro tanto*, the figure to be used in determining the carry-back remaining for application to 1945 net income.

While taxpayer seeks comfort from *Manning* v. *Seeley Tube & Box Co.*, 338 U.S. 561, the opinion in that case fairly supports the Government's position here. The issue in *Seeley Tube* was whether a taxpayer which failed to pay taxes when due and thus retained, over a period of time, "the use of funds which rightfully should have been in the possession of the United States" (p. 566) was excused from paying interest on a validly assessed deficiency because the deficiency was later abated by virtue of a loss carry-back. This Court properly held that later, unforeseeable events may not retroactively excuse a taxpayer's failure to pay taxes on the original due date. The Court took note, however, at the same time, that "for many purposes the carry-back is equivalent to a *de novo* determination of the tax . . ." (p. 567).

Unlike the situation in *Seeley Tube*, we are not determining here what the taxpayer was originally obliged to report and pay. We are seeking to ascertain what taxpayer is entitled to get back, by

way of relief, in view of the fact that it later suffered an unforeseeable loss. One would hardly suppose that Congress, in authorizing such a *de novo* determination, aimed to provide relief in respect of earlier taxes already in large measure refunded. The word "imposed" in Section 122(d)(6) plainly avoids that absurdity. As the Court of Appeals stated (R. 72):

> . . . it is *determined* income and excess profits taxes that represent the proper § 122(d)(6) adjustment, since the manifest purpose of the "carry-back" and "carry-over" provisions of the statute, § 122(b)(1), (2) is that the incidence of this kind of taxation upon a business enterprise shall in effect be looked at from the vantage point of a five year period, that is the current taxable year plus two "carry-back" and two "carry-over" taxable years.[26]

Taxpayer points out (Br., pp. 49-51) that, under the Court of Appeals' construction, it will receive

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[26] Taxpayer points (Br. 39-40) to Rev. Rul. 6, 1953-1 Cum. Bull. 120, which provides that in computing "section 102 net income" (the income upon which the penalty surtax on a corporation improperly accumulating surplus is imposed), the deduction for federal income taxes paid or accrued during the taxable year (Section 102(d)(1)(A)) means the amount of income tax accrued at the end of the taxable year without reduction resulting from a net operating loss carry-back of a later year. But that situation is not a comparable one. Congress did not intend that the penalty tax imposed under Section 102 should apply to income which a taxpayer was required to set aside for payment of income taxes in the amount known to him at the end of the taxable year. On the other hand, the plain purpose of the net operating loss provisions is to effect an exception to the annual period for tax accounting and to substitute a five-year unit. Note,

no special benefit from the provision in Section 122(b)(1) authorizing a "(d)(6)" adjustment. Taxpayer's claim that this is a "harsh result" (Br., p. 51) should not obscure the fact that the entire amount of the 1946 net operating loss has been applied *once* under the holding of the courts below. The full amount of the loss, found to have been $164,326.38, has been offset against taxpayer's net income for 1944 for purposes of determining taxpayer's liabilities for 1944. The effect of the decision is that no part of that sum is available again for offset in 1945 (in contrast to taxpayer's theory which would make the amount available once again *in toto*).[27] We agree with taxpayer that, under the holding below, Section 122(d)(6) has limited rather than broad application to accrual basis taxpayers. Typical situations in which it will benefit such taxpayers (either in computing net loss or net income) are discussed in the Government's brief in No. 10, pages 17-20. We cannot believe that the sweeping and truly astonishing results which taxpayer would attribute to "(d)(6)" are warranted either by the provision's

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also, that the language of Section 122(d)(6) differs significantly from that of Section 162(d)(1)(A) in that (d)(6) expressly limits the deduction to the "amount of tax *imposed*" (emphasis added).

[27] As noted earlier, taxpayer's contentions, if it prevailed under both Points I and II, would result in the conclusion that actual losses for 1946 and 1947 aggregating $950,709.63 offset completely aggregate profits for 1944 and 1945 of $1,654,119.31 and provide, additionally, a potential carry-over of more than $1,000,000.

terms or by its obscure history as a "technical" amendment.

CONCLUSION

The courts below were correct in holding (Point I) that an accrual basis taxpayer, computing a net operating loss for 1946, is not entitled to take into account excess profits taxes accrued in 1945 and paid in 1946. The finding that the 1946 net operating loss amounted to $164,326.38 is accordingly correct.

The decision below is also correct in holding (Point II) that, for purposes of determining the amount of 1946 carry-back available for application to 1945, taxpayer may not deduct from 1944 net income the amount of excess profits tax reported for 1944 but may only take into account, under the statutory formula (Section 122(b)(1), incorporating by reference Section 122(d)(6)), the amount of 1944 excess profits taxes ultimately found to be due.[28] The finding that the 1946 net

[28] Section 122(d)(6) is, of course, incorporated by reference in both Section 122(a) and Section 122(b)(1). Hence, if this Court should reverse on Question 1 and affirm on Question 2, the decision would affect *both* the computation of net operating loss for 1946 and the application of such loss to the prior years. Note that in both 1945 and 1943 taxpayer's reported excess profits taxes exceeded the amounts ultimately found due.

operating loss was absorbed in 1944 is accordingly correct.

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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APRIL, 1955.

APPENDIX A

For Internal Revenue Code of 1939, Sections 23(c)(1) and (s), 41, 43, 48(c), 122, 710(a)(1) and (b), 711(a)(1)(J) and (2)(L), and Treasury Regulations 111, Sections 29.41-1, 29.41-2, 29.43-1, 29.122-1 and 29.122-2, see Brief for the United States in the companion case of *United States* v. *Olympic Radio and Television, Inc.*, No. 10, Appendix A, pp. 36-53.

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> Sec. 29.122-4. *Computation of Net Operating Loss Carry-Overs and Net Operating Loss Carry-Backs.*—(a) *In general.*—The aggregate of any net operating loss carry-overs and any net operating loss carry-backs to a taxable year shall be the basis of the net operating loss deduction. In order to compute such deduction, the taxpayer must first determine the part of any net operating losses for the two preceding taxable years which are carry-overs to the current taxable year, and the part of any net operating losses for the two succeeding taxable years which are carry-backs to the current taxable year
>
> Under section 122 the net operating loss for any taxable year beginning on or after January 1, 1942, may be carried back to the two preceding taxable years (except any such taxable year which began before January 1, 1941) and may be carried over to the two succeeding taxable years. The net operating loss for any taxable year beginning before January 1, 1942, may be carried over to the two succeeding tax-

able years, regardless of whether such year begins before, on, or after January 1, 1941. The amount which is so carried back or carried over to any taxable year is the net operating loss to the extent it was not absorbed in the computation of the net income for other taxable years, preceding such taxable year, to which it was carried back or carried over. For the purpose of determining the net income for a taxable year which so absorbs the net operating loss that is carried back or carried over, the various net operating loss carry-overs and carry-backs to such taxable year are considered to be applied in reduction of the net income for such taxable year in the order of the taxable years from which such losses are carried over or carried back, beginning with the loss for the earliest taxable year.

(b) *Portion of net operating loss which is a carry-over or a carry-back to the current taxable year.*—The net operating loss sustained in any taxable year beginning before January 1, 1942, may be carried over to the two succeeding taxable years. The entire net operating loss may be carried over to the first succeeding taxable year, and the carry-over to the second succeeding taxable year is the excess of the net operating loss over the net income, if any, for the first succeeding taxable year (computed as provided in subsection (c) of this section). For example, the taxpayer had a net operating loss of $10,000 in 1940. It had a 1941 net income of $6,000 (computed as provided in subsection (c) of this section). The carry-over from 1940

to 1942 is $4,000, the excess of the $10,000 loss over the $6,000 net income for 1941.

The net operating loss sustained in any taxable year beginning on or after January 1, 1942, may be carried back to the two preceding taxable years (not considering as a preceding taxable year a year beginning prior to January 1, 1941) and may be carried over to the two succeeding taxable years. The entire net operating loss may be carried back to the second preceding taxable year. However, if the second preceding taxable year began before January 1, 1941, no part of the net operating loss may be carried back to such taxable year, and the net income for such taxable year does not reduce the amount of the net operating loss which may be carried back or carried over to the other taxable years. The net operating loss, to the extent it exceeds the net income, if any (computed as provided in subsection (c) of this section), for the second preceding taxable year, may then be carried back to the first preceding taxable year. To the extent that the net operating loss exceeds the aggregate of the net income, if any (computed as provided in subsection (c) of this section), for the two preceding taxable years, it may be carried over to the first succeeding taxable year. To the extent that the net operating loss exceeds the aggregate of the net income, if any (computed as provided in subsection (c) of this section), for the two preceding taxable years and for the first succeeding taxable year, it may be carried over to the second succeeding taxable year.

Example. The taxpayer has a net operating loss of $100,000 in 1943. It has net income (computed as provided in subsection (c) of this section) as follows: $10,000 in 1941, $15,000 in 1942, $35,000 in 1944, and $60,000 in 1945. The net operating loss carry-back from 1943 to 1941 is $100,000, an amount equal to the full net operating loss. The carry-back to 1942 is $90,000, the excess of the $100,000 net operating loss over the $10,000 net income for 1941 (computed as provided in subsection (c) of this section). The carry-over to 1944 is $75,000, the excess of the $100,000 net operating loss over the aggregate of the $10,000 net income for 1941 and the $15,000 net income for 1942 (computed in each instance as provided in subsection (c) of this section). The carry-over to 1945 is $40,000, the excess of the $100,000 net operating loss over the aggregate of the $10,000 net income for 1941, the $15,000 net income for 1942, and the $35,000 net income for 1944 (computed in each instance as provided in subsection (c) of this section).

(c) *Computation of net income which is subtracted from net operating loss to determine carry-back or carry-over.*—The net income for any taxable year which is subtracted from the net operating loss for another taxable year to determine the portion of such net operating loss which is a carry-back or carry-over to a particular taxable year as provided in subsection (b) of this section is computed with the following adjustments:

(1) The net operating loss deduction for such taxable year is computed by taking into

account only such net operating losses otherwise allowable as carry-overs or carry-backs to such taxable year as were sustained in taxable years preceding the taxable year in which the taxpayer sustained the net operating loss from which the net income is to be deducted.

Example. In computing the net operating loss deduction for 1945, the taxpayer has a carry-over from 1943 of $9,000, a carry-over from 1944 of $6,000, a carry-back from 1946 of $18,000, and a carry-back from 1947 of $14,000, or an aggregate of $47,000 in carry-overs and carry-backs which is the basis for the deduction. In computing the net income for 1945 which is deducted from the net operating loss for 1946 in order to determine the portion of such net operating loss which may be carried over to 1947 or 1948, the net operating loss deduction for 1945 is computed without taking into account the $18,000 carry-back from 1946 or the $14,000 carry-back from 1947. The net operating loss deduction for 1945 is, for the purposes of such computation, the aggregate of the $9,000 carry-over from 1943 and the $6,000 carry-over from 1944, or $15,000, adjusted as provided in section 29.122-5 (relating to the conversion of the aggregate of the net operating loss carry-overs and carry-backs to the taxable year into the net operating loss deduction).

In computing the net income for 1945 which is deducted from the net operating loss for 1947 in order to determine the portion of such loss which may be carried back to 1946 and carried over to 1948 and 1949, the net operat-

ing loss deduction for 1945 is computed without taking into account the $14,000 carry-back from 1947, and as so computed is the aggregate of the $9,000 carry-over from 1943, the $6,000 carry-over from 1944, and the $18,000 carry-back from 1946, or $33,000, adjusted as provided in section 29.122-5.

(2) In the case of a corporation, the net income shall be computed in accordance with the exceptions, additions, and limitations applicable in the computation of a net operating loss (see section 29.122-2), except that the net operating loss deduction shall be allowed to the extent provided in paragraph (1) above.

* * * * *

(4) (as amended by T. D. 5600, 1948-1 Cum. Bull. 5) Any deduction which is limited in amount to a percentage of the taxpayer's net income, or adjusted gross income for taxable years beginning after December 31, 1943, shall be recomputed upon the basis of the net income or adjusted gross income, as the case may be, determined with the adjustments prescribed in the preceding paragraph.

(5) The net income, as adjusted, shall in no case be considered less than zero.

(d) *Illustration of computation of net operating loss carry-backs and carry-overs.*—The application of this section may be illustrated by the following example:

Example. The taxpayer is a corporation making its income tax returns on the calendar year basis. It had no net operating loss in 1939

or 1940, or in 1948 or 1949. Its net income, computed without any net operating loss deduction (it being assumed that none of the other adjustments provided in subsection (c) of this section is applicable), was $20,000 in 1941, $35,000 in 1942, $30,000 in 1946, and $85,000 in 1947. It sustained net operating losses as follows: $25,000 in 1943, $50,000 in 1944, and $40,000 in 1945. It is assumed for the purposes of this example that the application of section 29.122-5 does not cause any reduction of the amount of the aggregate of the net operating loss carry-overs and carry-backs to any taxable year, so that such aggregate is the net operating loss deduction for such taxable year.

(1) The portions of the $25,000 net operating loss for 1943 which may be used as carry-backs to 1941 and 1942 and as carry-overs to 1944 and 1945 are computed as follows:

(A) For 1941, the carry-back is $25,000, that is, the amount of the net operating loss.

(B) For 1942, the carry-back is $5,000, that is, the excess of the $25,000 net operating loss over the $20,000 net income for 1941 (such net income being determined without any net operating loss deduction since there is no carry-over to 1941 from 1939 or 1940 and no carry-back from 1942, and the carry-back from 1943 is not taken into account).

(C) For 1944 and 1945, there is no carry-over of the net operating loss for 1943 since such loss does not exceed $55,000, the sum of the net incomes for the two taxable years preceding 1943 computed as provided in sub-

section (c) of this section (the $20,000 net income for 1941 and the $35,000 net income for 1942, there being no net operating loss deduction for either taxable year since the carry-backs from 1943 and from 1944 are not taken into account).

(2) The portions of the $50,000 net operating loss from 1944 which may be used as carry-backs to 1942 and 1943 and as carry-overs to 1945 and 1946 are computed as follows:

(A) For 1942, the carry-back is $50,000, that is, the amount of the net operating loss.

(B) For 1943, the carry-back is $20,000, that is, the excess of the $50,000 net operating loss over the $30,000 net income for 1942 (the $35,000 income for 1942 reduced by the $5,000 carry-back from 1943, the carry-back from 1944 not being taken into account).

(C) For 1945, the carry-over is $20,000, that is, the excess of the $50,000 net operating loss over $30,000, the sum of the $30,000 net income for 1942 (computed with the deduction of the $5,000 carry-back from 1943 and without the deduction of the carry-back from 1944) and the $0 net income for 1943 (a year in which a net operating loss was sustained).

(D) For 1946, the carry-over is $20,000, that is, the excess of the $50,000 net operating loss over $30,000, the sum of the $30,000 net income for 1942 (computed with the deduction of the $5,000 carry-back from 1943 and without the deduction of the carry-back from 1944) and the $0 net income for 1943

and 1945 (years in which net operating losses were sustained).

(3) The portions of the $40,000 net operating loss for 1945 which may be used as carry-backs to 1943 and 1944 and as carry-overs to 1946 and 1947 are computed as follows:

(A) For 1943, the carry-back is $40,000, that is, the amount of the net operating loss.

(B) For 1944, the carry-back is $40,000, that is, the excess of the $40,000 net operating loss for 1945 over $0, the net income for 1943 (a year in which a net operating loss was sustained).

(C) For 1946, the carry-over is $40,000, that is, the excess of the $40,000 net operating loss for 1945 over $0, the sum of the net incomes for 1943 and 1944 (years in which net operating losses were sustained).

(D) For 1947, the carry-over is $30,000, that is, the excess of the $40,000 net operating loss for 1945 over $10,000, the sum of the $0 net incomes for 1943 and 1944 and the $10,000 net income for 1946 (such net income for 1946 being computed as the $30,000 income reduced by the net operating loss carry-over of $20,000 from 1944, the $40,000 carry-over to 1946 from 1945 not being taken into account).

For 1941, the net operating loss deduction is determined to be $25,000, that is, the carry-back from 1943.

For 1942, the net operating loss deduction is determined to be $55,000, that is, the ag-

gregate of the carry-back of $5,000 from 1943 and of the carry-back of $50,000 from 1944.

For 1946, the net operating loss deduction is determined to be $60,000, that is, the aggregate of the $20,000 carry-over from 1944 and the $40,000 carry-over from 1945.

For 1947, the net operating loss deduction is determined to be $30,000, that is, the carry-over from 1945.

* * * * *

Sec. 29.122-5. *Conversion of Net Operating Loss Carry-Over Into Net Operating Loss Deduction.*—The net operating loss deduction for any taxable year is the aggregate of the net operating loss carry-overs and carry-backs to such taxable year computed as prescribed in section 29.122-4, reduced by the excess of the net income for such taxable year (computed in the same manner as the net income is computed for the purposes of section 29.122-4 except that no net operating loss deduction shall be taken into account and no deduction for excess profits tax imposed by subchapter E of chapter 2 shall be taken into account) over—

* * * * *

(2) in the case of a corporation, the normal-tax net income computed without regard to the exceptions, additions, and limitations specified in section 29.122-2 except that no net operating loss deduction shall be taken into account and the credit provided in section 26 (e) for income subject to the excess profits tax shall not be allowed.

The application of this section may be illustrated by the following example:

Example. The aggregate of the net operating loss carry-overs and carry-backs to 1942 for the X Corporation is $55,000. Its net income for 1942, computed with the adjustments required by this section, is $450,000 and its normal-tax net income, computed without any exceptions, additions, and limitations except that no net operating loss deduction is allowed and the credit provided in section 26 (e) for income subject to the excess profits tax is not allowed, is $445,000. The net operating loss deduction available to the X Corporation for the year 1942 is $50,000, computed as follows:

Aggregate of net operating loss carry-overs and carry-backs to 1942	$55,000
Less: Excess of net income for 1942, with adjustments, over normal-tax net income for 1942, without adjustments except that no net operating loss deduction shall be allowed and the credit provided in section 26(e) for income subject to the excess profits tax shall not be allowed ($450,000 minus $445,000)	5,000
Net operating loss deduction for 1942	$50,000

* * * * *

APPENDIX B

Example 1

Illustration of Computation of Corporate Income and Excess Profits Taxes of Taxpayer with Stable Income for Taxable Years Ended September 30, 1944, to September 30, 1947

The hypothetical X Corporation with income of $187,385 for each of the four years above stated would have paid excess profits and income taxes aggregating $427,393 on total income of $749,543.44.

Schedule 1

Year Ended	*Net Income*	*Tax Liability*	
September 30, 1944	$187,385.86	Income -	$ 20,160.75
		Excess profits -	115,316.59
September 30, 1945	$187,385.86	Income -	19,046.86
		Excess profits -	114,340.39
September 30, 1946	$187,385.86	Income -	58,116.29
		Excess profits -	29,634.81
September 30, 1947	$187,385.86	Income -	70,777.63
Total	$749,543.44		$427,393.32

The excess profits credit and adjustments of X Corporation closely follow those for Lewyt Corporation contained in the record.

Year Ended September 30, 1944

Schedule 2

Computation of Income Tax

	1943 Law	1944 Law
Average net income (Schedule 1)	$187,385.86	$187,385.86
Less income subject to excess profits tax	140,474.82	135,474.82
Income subject to normal and surtax	$ 46,911.04	$ 51,911.04

Normal tax ($4,250.00 plus 31% of $21,911.04)	$ 11,042.42	
(24% of $51,911.04)		$ 12,458.65
Surtax ($2,500.00 plus 22% of $21,911.04)	7,320.43	
(16% of $51,911.04)		8,305.77
Tota' normal and surtax	$ 18,362.85	$ 20,764.42

II

Income tax for each period:	
At 1943 rates (92/366 of $18,362.85)	$ 4,615.80
At 1944 rates (274/366 of $20,764.42)	15,544.95
Income tax for fiscal year 1944	$ 20,160.75

Schedule 3

Computation of Excess Profits Tax

Average net income		$187,385.86	$187,385.86
Plus 50% of interest on borrowed capital		10,172.09	10,172.09
Average excess profits net income		$197,557.95	$197,557.95
Less:			
Specific exemption	$ 5,000.00 $10,000.00		
Excess profits credit	$52,083.13 $52,083.13	$ 57,083.13	$ 62,083.13
Income subject to excess profits tax		$140,474.82	$135,474.82
Excess profits tax (90% of $140,474.82; 95% of $135,474.82)		$126,427.34	$128,701.08
Surtax net income computed without Sec. 26(e) credit		$187,385.86	$187,385.86
80% of $187,385.86		$149,908.69	$149,908.69
Less income tax		$ 18,362.85	$ 20,764.42

Excess profits tax as limited	$131,545.84	$129,144.27
Applicable excess profits tax	$126,427.34	$128,701.08
Amount brought forward	$126,427.34	$128,701.08
Tax for period in 1943 (92/366 of $126,427.34)		$ 31,779.55
Tax for period in 1944 (274/366 of $128,701.08)		$ 96,349.99
Excess profits tax		$128,129.54
Less 10% post war credit		12,812.95
Excess profits tax liability		$115,316.59

Year Ended September 30, 1945

Schedule 4

Computation of Income Tax

Average net income (Schedule 1)	$187,385.86
Less net long term capital gain	10,321.38
Ordinary net income	$177,064.48
Less income subject to excess profits tax	133,731.45
Income subject to normal and surtax	$ 43,333.03
Normal tax ($4,250.00 plus 31% of $18,333.03)	$ 9,933.24
Surtax ($2,500.00 plus 22% of $18,333.03)	6,533.27
25% of net long term capital gain of $10,321.38	2,580.35
Income tax	$ 19,046.86

Schedule 5

Computation of Excess Profits Tax

Average net income (Schedule 1)		$187,385.86
Plus 50% of interest on borrowed capital		11,262.18
Average excess profits net income		$198,648.04
Less:		
Specific exemption	$10,000.00	
Excess profits credit	54,916.59	$ 64,916.59
Income subject to excess profits tax		$133,731.45
95% of $133,731.45		$127,044.88

Surtax net income computed without Sec. 26(e) credit	$187,385.86
80% of $187,385.86	$149,908.69
Less income tax	19,046.86
Excess profits tax as limited by the 80% computation	$130,861.83
Applicable excess profits tax	$127,044.88
Less 10% post war credit	12,704.49
Excess profits tax liability	$114,340.39

Year Ended September 30, 1946

Schedule 6

Computation of Income Tax

	1945 Law	1946 Law
Average net income (Schedule 1)	$187,385.86	$187,385.86
Less income subject to excess profits tax	138,759.23	-0-
Income subject to normal and surtax	$ 48,626.63	$187,385.86
Normal tax:		
Under 1945 law ($4,250.00 plus 31% of $23,626.63)	$ 11,574.26	
Under 1946 law (24% of $187,385.86)		$ 44,972.61
Surtax:		
Under 1945 law ($2,500.00 plus 22% of $23,626.63)	7,697.86	
Under 1946 law (14% of $187,385.86)		26,234.02
Total normal and surtax	$19,272.12	$ 71,206.63
Income tax for each period:		
Tax for period in 1945 (92/365 of $19,272.12)		$ 4,857.63
Tax for period in 1946 (273/365 of $71,206.63)		53,258.66
Income tax for fiscal year 1946		$ 58,116.29

Schedule 7

Computation of Excess Profits Tax

Average net income		$187,385.86
Plus 50% of interest on borrowed capital		8,076.26
Average excess profits net income		$195,462.12
Less:		
Specific exemption	$10,000.00	
Excess profits credit	46,702.89	$ 56,702.89
Income subject to excess profits tax		$138,759.23
Tentative excess profits tax (95% of $138,759.23)		$131,821.27
Surtax net income computed without Sec. 26(e) credit		$187,385.86
80% of $187,385.86		149,908.69
Less income tax		19,272.12
Excess profits tax as limited by 80% computation		$130,636.57
Tentative excess profits tax (smaller of $131,821.27 or $130,636.57)		$130,636.57
Excess profits tax for excess profits tax period (92/365 of $130,636.57)		$ 32,927.57
Less 10% post war credit		3,292.76
Excess profits tax		$ 29,634.81

Year Ended September 30, 1947

Schedule 8

Computation of Income Tax

Average net income	$187,385.86
Less net long term capital gain	3,300.00
Ordinary net income	$184,085.86

Normal tax (24% of $184,085.86)	$ 44,180.61
Surtax (14% of $184,085.86)	25,772.02
25% of net long term capital gain of $3,300.00	$ 825.00
Income tax	$ 70,777.63

Example 2

Illustration of Tax Effect of Contrasting Contentions of Taxpayer and Government With Respect to Computation of Net Operating Loss Under Section 122(a) and (d)(6).

In each of the years 1942 to 1945 the excess profits tax was in effect. A Corporation and B Corporation are taxpayers on the accrual basis. Assume each has an excess profits credit for each year of $45,000.

TAXPAYER A CORPORATION

Year	*Net Income*	*Total tax according to Gov't's contention*	*Total tax applying Lewyt's contention*
1942	740,000	380,000	—0—
1943	775,000	—0—	—0—
1944	(200,000)	—0—	—0—
1945	(775,000)	—0—	—0—
Aggregate	$540,000	$380,000	—0—

TAXPAYER B CORPORATION

Year	*Net Income*	*Total Tax*
1942	135,000	88,850.00
1943	135,000	88,850.00
1944	135,000	90,400.00
1945	135,000	90,400.00
Aggregate	$540,000	$358,500.00

SCHEDULE 1

Computation of Income and Excess Profits Tax for 1942 for A Corporation According to Government's Contention

1. Net Income (prior to sec. 26(e) credit and carryback of 1944 net operating loss)		$740,000.00
2. Less:		
1944 net operating loss..	$200,000.00	
Adjusted excess profits net income (line 9 below)..	400,000.00	600,000.00
3. Normal tax net income....		$140,000.00
4. Normal tax — 24%.....		33,600.00
5. Surtax — 16%.....		22,400.00
6. Income tax		$ 56,000.00
7. Excess profits net income (line 1 above)		$740,000.00
8. Less:		
Specific exemption	$ 5,000.00	
Excess profits credit for 1942	45,000.00	
Excess profits credit for 1943	45,000.00	
Excess profits credit for 1944	45,000.00	
Net operating loss for 1944	200,000.00	340,000.00
9. Adjusted excess profits net income		$400,000.00

10. 90% of $400,000.00		$360,000.00
11. Computation of the 80% limitation:—		
12. Surtax net income (after carryback but prior to sec. 26(e) credit)	$540,000.00	
13. 80% of $540,000.00	432,000.00	
14. Less: Chapter I income tax (line 6 above)	56,000.00	
15. Limitation of excess profits tax	$376,000.00	
16. Excess profits tax (lesser of $376,000.00 and $360,000.00)		$360,000.00
17. Less: Post war credit....		36,000.00
18. Net excess profits tax....		$324,000.00

SCHEDULE 2

Computation of Income and Excess Profits Tax for 1942 for A Corporation According to Taxpayer Lewyt's Contention

1. Net income (prior to sec. 26(e) credit and carryback of 1944 net operating loss)		$740,000.00
2. Less: 1944 net operating loss	$200,000.00	
1943 excess profits tax paid in 1944 (line 13 below)	540,000.00	740,000.00
3. Normal tax net income...		—0—
4. Income tax		—0—
5. Excess profits tax.....		—0—

Computation of 1943 excess profits tax paid in 1944
(before carryback of 1945 net operating loss)

6. Excess profits net income for 1943 before carryback		$775,000.00
7. Less:		
Specific exemption	$ 5,000.00	
Excess profits credit	45,000.00	50,000.00
8. Adjusted excess profits net income		$725,000.00
9. 90% of $725,000.00		$652,500.00
10. Computation of the 80% limitation Surtax net income (prior to sec. 26(e) credit)	$775,000.00	
80% of $775,000.00	620,000.00	
Less: Chapter I income tax	20,000.00	
Limitation of excess profits tax	$600,000.00	
11. Excess profits tax for 1943 (lesser of $652,500.00 and $600,000.00)		$600,000.00
12. Less: Post war credit		60,000.00
13. Net excess profits tax		$540,000.00

SCHEDULE 3

Computation of Income and Excess Profits Tax for 1943 for A Corporation According to the Government's Contention

1. Net income (prior to sec. 26(e) credit and carryback of 1945 net operating loss)	$775,000.00
2. Less: 1945 net operating loss	775,000.00
3. Normal tax net income	—0—
4. Income tax	—0—
5. Excess profits net income (line 1 above)	$775,000.00
6. Less: 1945 net operating loss	775,000.00

7. Adjusted excess profits net income.....	—0—
8. Excess profits tax	—0—

Schedule 4

Computation of Income and Excess Profits Tax for 1942 for B Corporation (Same Computation for 1943)

1. Net Income (prior to sec. 26(e) credit)		$135,000.00
2. Less: Adjusted excess profits net income (line 9 below)		85,000.00
3. Normal tax net income		$ 50,000.00
4. Normal tax—24%		12,000.00
5. Surtax—16%		8,000.00
6. Income tax		20,000.00
7. Excess profits net income (line 1 above)		$135,000.00
8. Less:		
Specific exemption	$ 5,000.00	
Excess profits credit	45,000.00	50,000.00
9. Adjusted excess profits net income		$ 85,000.00
10. 90% of $85,000.00		$ 76,500.00
11. Computation of the 80% limitation:—		
Surtax net income (prior to sec. 26(e) credit)	$135,000.00	
80% of $135,000.00	108,000.00	
Less: Chapter I income tax (line 6 above)	20,000.00	
Limitation of excess profits tax	$ 88,000,00	
12. Excess profits tax (lesser of $88,000.00 and $76,500.00)		$ 76,500.00
13. Less: Post war credit		7,650.00
14. Net excess profits tax		$ 68,850.00

Schedule 5

Computation of Income and Excess Profits Tax for 1944 for B Corporation (Same Computation for 1945)

1. Net income (prior to sec. 26(e) credit)		$135,000.00
2. Less: Adjusted excess profits net income (line 9 below)		80,000.00
3. Normal tax net income		$ 55,000.00
4. Normal tax—24%		13,200.00
5. Surtax—16%		8,800.00
6. Income tax		22,000.00
7. Excess profits net income (line 1 above)		$135,000.00
8. Less:		
Specific exemption	$ 10,000.00	
Excess profits credit	45,000.00	55,000.00
9. Adjusted excess profits net income		$ 80,000.00
10. 95% of $80,000.00		$ 76,000.00
11. Computation of the 80% limitation:—		
12. Surtax net income (prior to sec. 26(e) credit)	$135,000.00	
13. 80% of $135,000.00	108,000.00	
14. Less: Chapter I income tax (line 6 above)	22,000.00	
15. Limitation of excess profits tax	$ 86,000.00	
16. Excess profits tax (lesser of $86,000.00 and $76,000.00)		$ 76,000.00
17. Less: Post War credit		7,600.00
18. Net excess profits tax		$ 68,400.00

Example 3

Additional Illustration of Tax Effect of Contrasting Contentions of Taxpayer and Government With Respect to Computation of Net Operating Loss Under Section 122(a) and (b)(6).

This example differs from example 2 in that the taxes are computed for the years 1944 to 1947, the years involved in the Lewyt case. The excess profits tax was not imposed in 1946 and 1947. C Corporation and D Corporation are on the accrual basis. Assume each has an excess profits credit for each year of $70,000.

TAXPAYER C CORPORATION

Year	*Net Income*	*Total Tax According to Govt.'s Contention*	*Total Tax Applying Lewyt's Contention*
1944	650,000	284,650	—0—
1945	665,000	—0—	—0—
1946	(200,000)	—0—	—0—
1947	(665,000)	—0—	—0—
Aggregate	$450,000	$284,650	—0—

TAXPAYER D CORPORATION

Year	*Net Income*	*Total Tax*
1944	112,500	59,787.50
1945	112,500	59,787.50
1946	112,500	42,750.00
1947	112,500	42,750.00
Aggregate	$450,000	$205,075.00

SCHEDULE 1

Computation of Income and Excess Profits Tax for 1944 for C Corporation According to Government's Contention

1. Net income (prior to sec. 26(e) credit and carry-back of 1946 net operating loss)		$650,000.00
2. Less:		
1946 net operating loss	$200,000.00	
Adjusted excess profits net income (line 9 below)	230,000.00	430,000.00
3. Normal tax net income...		220,000.00
4. Normal tax — 24%.....		52,800.00
5. Surtax — 16%.....		35,200.00
6. Income tax		$ 88,000.00
7. Excess profits net income (line 1 above)		$650,000.00
8. Less:		
Specific exemption	$ 10,000.00	
Excess profits credit for 1944.....	70,000.00	
Excess profits credit for 1945.....	70,000.00	
Excess profits credit for 1946.....	70,000.00	
Net operating loss for 1946	200,000.00	420,000.00
9. Adjusted excess profits net income		230,000.00
10. 95% of $230,000.00.....		218,500.00
11. Computation of the 80% limitation:—		
12. Surtax net income (after CB but prior to sec. 26(e) credit)	$450,000.00	

13. 80% of $450,000.00	360,000.00	
14. Less: Chapter I income tax (line 6 above)	88,000.00	
15. Limitation of excess profits tax	$272,000.00	
16. Excess profits tax (lesser of $272,000.00 and $218,500.00)		$218,500.00
17. Less: Post war credit.....		21,850.00
18. Net excess profits tax....		$196,650.00

SCHEDULE 2

Computation of Income and Excess Profits Tax for 1944 for C Corporation According to Taxpayer Lewyt's Contention

1. Net income (prior to sec. 26(e) credit and carryback of 1946 net operating loss)		$650,000.00
2. Less: 1946 net operating loss	$200,000.00	
1945 excess profits tax paid in 1946 (line 13 below)	450,000.00	650,000.00
3. Normal tax net income		—0—
4. Income tax		—0—
5. Excess profits tax		—0—

Computation of 1945 excess profits tax paid in 1946 (before carryback of 1947 net operating loss)

6. Excess profits net income for 1945 before carryback		$665,000.00
7. Less:		
Specific exemption	$10,000.00	
Excess profits credit	70,000.00	80,000.00
8. Adjusted excess profits net income		$585,000.00
9. 95% of $585,000.00		555,750.00
10. Computation of the 80% limitation:—		
Surtax net income (prior to sec. 26(e) credit)	$665,000.00	

80% of $665,000.00	532,000.00	
Less: Chapter I income tax	32,000.00	
Limitation of excess profits tax	$500,000.00	
11. Excess profits tax for 1945 (lesser of $555,750.00 and $500,000.00		$500,000.00
12. Less: Post war credit		50,000.00
13. Net excess profits tax		$450,000.00

SCHEDULE 3

Computation of Income and Excess Profits Tax for 1945 for C Corporation According to Government's Contention

1. Net income (prior to sec. 26(e) credit and carryback of 1947 net operating loss)	$665,000.00
2. Less: 1947 net operating loss	665,000.00
3. Normal tax net income	—0—
4. Income tax	—0—
5. Excess profits net income (line 1 above)	$665,000.00
6. Less: 1947 net operating loss	665,000.00
7. Adjusted excess profits net income	—0—
8. Excess profits tax	—0—

SCHEDULE 4

Computation of Income and Excess Profits Tax for 1944 for D Corporation (Same Computation for 1945)

1. Net income (prior to sec. 26(e) credit)	$112,500.00
2. Less: Adjusted excess profits net income (line 9 below)	32,500.00
3. Normal tax net income	80,000.00
4. Normal tax—24%	19,200.00
5. Surtax—16%	12,800.00
6. Income tax	$32,000.00
7. Excess profits net income (line 1 above)	$112,500.00

8. Less:		
Specific exemption	$10,000.00	
Excess profits credit	70,000.00	80,000.00
9. Adjusted excess profits net income		$32,500.00
10. 95% of $32,500.00		30,875.00
11. Computation of the 80% limitation:—		
Surtax net income (prior to sec. 26(e) credit)	$112,500.00	
80% of $112,500.00	90,000.00	
Less: Chapter I income tax (line 6 above)	32,000.00	
Limitation of excess profits tax	$58,000.00	
12. Excess profits tax (lesser of $58,000.00 and $30,875.00)		$30,875.00
13. Less: Post war credit		3,087.50
14. Net excess profits tax		$27,787.50

SCHEDULE 5

Computation of Income Tax for 1946 for D Corporation
(Same Computation for 1947)

1. Normal tax net income	$112,500.00
2. Normal tax—24%	27,000.00
3. Surtax—14%	15,750.00
4. Income tax	$42,750.00

Example 4

Computation of taxpayer's 1946 and 1947 net operating loss carry-overs to 1948 and 1949

(Application of taxpayer's contentions to Section 122(b)(2))

1947 net operating loss	$ 786,383.25*		
1946 net operating loss	1,025,444.42		
Total net operating loss available for carry-over to 1948			$1,811,827.67
Less: 1944 income as adjusted (see p. 29, *supra*)			—0—
Less: 1945 net income (R. 10-11)	1,069,252.50*		
Less: 1944 excess profits tax reported by taxpayer paid in 1945 (Sec. 122(b)(2))	510,939.23 (R. 24)		558,313.27
Net operating loss carry-over to 1948			$1,253,514.40

Accepting taxpayer's contentions and applying the same formula, this carry-over restricted to the amount of $786,383.25 (due to the two-year limitation on carry-overs) would be available for carry-over to 1949.

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* The figures used are those contained in the record, stated in the Commissioner's deficiency determination and found by the Tax Court. Disallowance of the interest deduction of $55,949.04 for 1947 (fn. 3, *supra*, p. 4 and resulting minor adjustments would effect roughly proportionate changes, but not the principle applicable or the approximate amounts. Thus, the carry-over to 1948 would then be $1,187,243.98.

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